CHAPTER - X
ECONOMIC POLICIES FINDINGS AND SUGGESTIONS

INTRODUCTION :

In 1980s many developing countries were followed adjustment, as countries underwent painful programs like Stabilization and embarked on measures designed to bring about medium term improvements in the structure of the economy. Particularly on the supply side. Privatisation lay at the confluence of these goals. Many governments embraced the idea of privatization as a possible solution to the dire straits into which the SOE sector had fallen, and as a means of stanching flow of funds to these SOEs from the public sector. Further privatization has been instrumental in policy programmes aimed at broaden adjustment issues. In part this was because privatization viewed as a n integral part of a reform package including trade liberalization, Price deregulation, fiscal stabilization and these policies were conceptually quite separate. More logically, however privatization as a part of adjustment because its close links to the longer term objectives of private sector and capital market development.

Governments also embraced privatization because the SOEs had disappointed in their role as distributors of rents towards favored income. The Laissez afire approach to the efficient management of SOEs had fostered a small group of rentiers for whom the distributional effect of state ownership were positive and often sizeable, but at the cost of falling efficiency in operations and increasingly unsustainable fiscal disequilibrium.
Second, attempts to spread benefits more widely through price control and cross-subsidization not only were excessively blunt, but were also undermined by poor output quality, erratic service and the emergence of rationing.

10.1 OUTCOMES:

Despite the apparent priority accorded to privatization by governments the results by and large have not supported expectations. In part this is because of the expected effects will only be manifest in the medium term, but more important is the fact that much less progress in actual implementation has been made than was initially envisaged. With the exception of Jamaica, there has been no substantive shift in ownership of national wealth from public to private sectors, and even in Jamaica the cumulative proceeds of privatization from 1981 to 1990 constituted only 7.2% of GDP elsewhere notably in Malaysia, which quickly acquired a reputation as a major privatized, the scale of privatization in the 1980s was a little. there has however, been some measurable improvement in the overall performance of the SOE sector during the period. For one thing the creation of new SOEs has come to a virtual halt, not least in areas such as manufacturing and services. But more importantly, SOE reform has directly contributed much more to the rationalization of public finances than has privatization and indeed has been an important factor in the overall improvement of fiscal balances, price and tariff restructuring, production rationalization restructuring of management and capital government has featured strongly in this
Where as accounting for the flow of funds from the privatization exercise is relatively straightforward, the identification of efficiency gains is more difficult. In many instances the sale of the public asset has been too recent to expect any such gains to be clear, but more often the nature of the sale and the environment in which it proceeded have served to negate any positive effects which might have been expected. Earlier privatization has almost as many objectives as the policy it was supposed to supplant, viz., state ownership of the means of production. As in the case of state ownership simultaneous achievement of all these objectives is not possible. Thus one of the key findings are internal ranking of the multiple goals of privatization usually greatly down-played the importance of attaining efficiency improvements. In particular the study examined the factors economic and political, public finance needs and the pressure from external creditors shaped sales in a manner unconducive to the achievement of this core objective.

Concerning Privatization and its broader objectives, namely private sector and capital market development changing income distribution and the meeting of loan disbursement conditions, achievements have been limited countries have made progress in attaining these objectives, but this has not in general been due to privatization. Private sectors have become more competitive during the decade but this was principally as a result of trade policy reform and domestic price liberalization rather than
explictly because of privatization. Similarly, Capital market
development and the pursuit of wider share ownership have depended
more on financial liberalization and broader economic deregulation
than on the stimulus created by the supply of equity in privatized
enterprises. In both cases there have been some positive impulses
from privatization but as we have argued these are limited by the
structural constraints that weak private sectors and thin capital
markets have themselves placed on privatization.

Income distribution (both international and internal) has
proved to be one of the most binding constraints on the entire
privatization process in a number of countries it has effectively
suffocated all other aspects of the debate, while in others where
privatization has turned on the complexities of these concerns it
has induced significant distortions in the design and
implementation of programmes. In the case of foreign ownership,
these problems have been particularly acquire. Faced with limited
domestic demand many governments have faced the choice of either
selling assets to the foreign sector and incurring heavy losses,
or continuing to hold them in the public sector. Further more the
management of sales to the foreign sector has raises compete issues
of regulation.

Finally the evidence of the 1980s has shown that
privatization took place uncomfortably within the disbursement
conditions of policy based lending. many countries have embarked
on programmed of privatization within the framework of structural
adjustment programmes and the pressure to meet these criteria has
on occasion, led to poor management of the programme and inadequate preparation of enterprises for sale. More common, however has been the tendency for donors to tolerate slippage of loan conditionality as it became clear that the rapid implementation of privatization during a period of often quite severe stabilization measures could be a costly exercise. Despite of policy based lending rarely was a failure to privatize an enterprise a sufficient reason to half the disbursement of aid flows.

10.2 EVALUATION :

Though study is based on a selected small sample of countries in which privatization has in some cases been a marginal activity, it is clear the problems and issues in these countries provide appropriate archetypes for a wide range of economies. though the problems held in Eastern Europe of re-orientating an entire economy arr of a different type, for most other developing countries the issues raised here are germane, if of differing order of magnitude. Supporting this is the fact that a number of the more recent works which tough on privatization have echoed the findings and conclusions in this study.

We are trying to explain very significant short fall between the experience of privatization and original expectations, and focused on two important aspects, first, and fundamentally, we have stressed on speed, form and economic effects of privatization

will be ultimately determined by the structural and regulatory limitations of the economy. However privatization does not occur in a vacuum and thus the second important argument of the study highlights the pervasive effects that political considerations have had on the design and implementation of privatization programmes. Consequently it is the tensions between the economic and politics of privatization and also between the various objectives of privatization itself, that have shaped privatization which will determine the short-term outlook for programmes in the next coming future. Concerning the first argument the thrust of the analysis has been to make explicit theoretical arguments for privatization which rely significantly on assumptions about economic structure that are more appropriate for developed than developing countries, comparing these with the features of selected country studies gives us a basis for deciding how to adjust developing economies of what privatization can and can not be expected to achieve in low to middle income countries. Significantly economic theory highlights the importance of information flows and incentive mechanisms for efficient management and of market structure and regulation for the efficient allocation of resources. In developing countries however information flows are frequently weak. Under public ownership, performance indicators have tended to be denominate in quantitative terms (such as employment, out put, public assets) and prices themselves, often set by and layered with extensive cross subsidization, rarely transmitted information on true
resource costs. Moreover these distortions frequently pervaded all economic sectors regardless of ownership, through the effects of wide spread domestic price controls and complex trade policy. Transfer of ownership may eliminate some of the more extreme elements of the weak internal processing of information, but this will be of only limited value if broader price distortions remain.

Similarly limited market size (which means that natural monopoly becomes a common occurrence) extensive concentration of economic power, institutional linkages and limited import penetration in certain sectors have served to limit competition on the supply side. Monopolistic and Oligopolistic enterprises thus dominate the domestic economy many of which (especially in the smaller economies) are state-owned. Privatization of such enterprises without restructuring of the enterprise itself or without associated changes in market structure may have no measurable impact on enterprise performance. These structural limitations of the domestic economy in developing countries are so pervasive that effective regulation of market against the adverse effects of monopoly and oligopoly becomes an essential adjunct to virtually all substantial privatization initiatives, rather than, as in many industrialized economies a specific requirement in respect of the sale of a small number of monopoly utilities. One of the most worrying features of privatization in developing countries is the extremely low priority accorded to market regulation and competition policy. However, even if this were reversed the evidence suggests that a number of countries have
some way to go before the capacity would exist to implement efficient and credible regulation.

The absence of efficient means of savings mobilization for equity investment remains an important constraint to implementation of privatization objectives in a number of the poorer developing countries such as Malawi and PNG, governments in these countries are constrained in the form and size of sales. What is more without trad-ability of assets they face lower realizable prices for them and by being unable to unbundle asset entitlements they face the prospects of re-concentration of asset ownership in the hands of a small private sector elite.

There are of course feed backs from privatization to the development of private sector capital market and regulatory structures but these are weak and the process of trying to accelerate privatization may be ultimately harmful. Over burdening the absorptive capacity of Govt., may ultimately result in privatization become a welfare reducing activity as rents are captured by powerful buyers capital markets are distorted and the loss of regulatory credibility produces negative externalities in other areas. Privatization has been a politically contentious policy often regarded either as a line of demarcation between political parties in pluralistic countries or as a threat to the economic well being of rentiers. Its implementation has as a result often been undertaken as an article of political faith, but at the same time with an extreme sense of caution. Moreover, in many developing countries it is closely combined with a range of
other related adjustment policies and political objectives and has been pursued in the midst of painful stabilization policies / measures. Conflicts abound and for risk averse or cautious governments often lacking credibility in the eyes of domestic investors and foreign investors this has meant that the economic objectives of privatization are frequently a compromised as a result of political factors. While such expediency may in some case be economically rational in a dynamic sense (in that it is necessary to create a reputation with buyers to ensure market receptivity for the future) it does underlines the important fact that putting privatisation in the reform package can often be achieved only with significant revenue and efficiency costs. Similarly though privatisation is essentially concerned with the transfer of commercial risk to the private sector this is often compromised by implicit under writing of the private sector in privatization sales by politically cautious government.

The reality of privatization in developing countries has not met expectations. It remains a priority however and as many countries move into a second decade of privatization is valuable to consider what adjustments to the policy are require for privatization to play a useful role in medium term economic reform in developing countries.

10.3 ADJUSTING THE ECONOMY AND PRIVATIZATION:

There is no doubt in the current wave of market friendly development privatization will remain a major component of economic policy packages in the recent future. Moreover we have
seen in Jamaica and Sri Lanka as opposition to the policy diminishes, programmed of privatization are likely to be less motivated and less designed around the narrow objective of securing success.

The first adjustment is required if privatization is to be effective in achieving its efficiency enhancing objectives is that it be clearly regarded as a medium term supply side policy a logical complement to broader private sector development. The ultimate goal of developing countries is a competitive private sector, and as goods and capital markets and regulatory capacity develop and deepen so privatization is inevitably going to greater the higher the level of development in the economy. Consequently objective of the policy should be the development of the private sector and the capital markets. Privatization should fall within these objectives, with more attention being paid to the direct economic objectives and allowing the politics to die away. Second it is doubtful that privatization can play any major role in the short run in the face of adverse structural economic conditions. Endemic investment, uncertainty problems of policy credibility and the political forces impinging on governments as they attempt to being about economic stabilization are not conducive to the success of privatization and in such a cases privatization for the short run should be down graded and donors should reassess its role within adjustment programs. Judicious privatization especially through the sale of smaller enterprises as still valuable, but attempts to accelerate privatization programmes will vitate the
goals they are supposed to achieve on two fronts not only will the programme come up against the binding constraints of the economy but also the political intervention required to secure the success of privatization in-period of crisis may actually lock-in welfare reducing elements. Underwriting and under pricing arrangements guarantees on market access and over generous restructuring which are required to see sales proceed in such circumstances are precisely such impediments to efficiency enhancing privatization.

Finally in view of these concerns it is essential that the current capacity of the domestic private sector to absorb public asset sales and therefore expectations of the scale of privatization programmes is reassessed. Privatization pipelines are still extremely optimistic and across a number of countries they have already been seen to slip or to be implemented in a hurried and sub-optimal level. Only a fraction of the Sri Lankan pipeline for 1990 and 1991 has been implemented while the same is the case with the ambitious privatization master plain Malaysia and the second wave of Privatization in Jamaica and Trinidad and Tobago.

These views obviously put forward the questions how then governments to proceed in tackling the still prevent short term crisis of the SOE sector, that direct reform SOEs combined with market based regulatory frameworks will offer much more fundamental adjustments in resource use than will rapid privatization. An SOE reform would not persist and that it was only with the threat of privatization that efficiency gains could
be locked in. However though this had in the early 1980s, it seems less powerful now. first there is evidence that the threat effect has been established, governments have abandoned the creation of SOEs as major tools of economic policy and the prevailing political sentiments is firmly based in the demand for efficient services from SOEs. Secondly having established privatization as a medium term option, SOE reform within a broader framework of market development is consistent in a way that it was not in an environment of non-market pricing and control. thus the establishment of market based regulatory structures for the SOE sector allows government to practice and develop their regulatory capacity to implement appropriate and effective competition policy and to create the information and incentive structures that will be robust enough to ensure that eventual privatization can be successful. Paradoxically then given the constraints placed on immediate privatization by the economic structure of many developing countries, one policy for strengthening market orientation in these economies is the intelligent reform of the SOE sector structures around sound economic principles. In combination with a reduction in the urgency currently assigned to privatization and the revision of programmes around a medium term efficiency oriented framework this will allow to assess more clearly the relative costs and benefits of competing policy alternatives in pursuit of the efficient supply of goods and services in a manner consistent with the ultimate welfare objectives of government and economy.
10.4 ECONOMIC POLICIES:

Made fashionable by the Britain in early 1980s Privatization is now vague around the developing world, it has become an important policy ingredient in the swing to reliance on markets which characterizes economic reforms now under way in the second and third worlds. In part this is because greater emphasis on free markets and on privatization as a means of markets works better.

Experience with the developed economies is generally seen as successful though that view is not exactly shared universally. Closer scrutiny of Privatization experience over the past decade in the developing economies suggests us in reality that the process and its outcomes are neither as simple nor as straightforward as is often envisaged.

This study found that the existence of reasonably competitive domestic markets for goods and services, a well developed capital markets with considerable breadth and absorptive capacity and sound regulatory structures which have evolved over decades. The absence of these essential prerequisites makes achieving all the benefits of privatization much more difficult the success of Privatization is largely dependent on strategic tactical choices for sale from a public asset portfolio, pricing and appropriate time sequencing.

The fundamental objective of Indian Privatization to bring rapid and sustained improvement in the efficiency of State Owned Enterprises (SOEs) successful and sustained growth and development
depends on continuing increases in the productivity of capital aland and labour. Fostering an economic environment which promotes rapid, fast development will not be so easy within a generation the countries of east Asia have transformed themselves.

To ease out the 1991 crisis stabilization measures undertaken by the Indian Government and the initiation of a medium term strategy for consolation of macro economic stability and undertaking long structural reforms in the foreign trade and payments regime, the tax system, industrial policy and financial sectors.

The controls began in 1950s and served a purpose in the initial years of development had overtime became inefficient and dysfunctional very often the system served only to protect established producers from competition by new entrants.

As the part of Indian reforms Government has took many measures to dismantle the controls.

* Industrial licensing was abolished for all except a selected list of hazardous and environmentally sensitive industries.
* The separate permission needed by MRTP houses for investment and expansion was abolished.
* The list of industries reserved for the public sector was reduced from 17 to 6 in addition private sector participation was allowed even industries in the reserved list.
* Access to foreign technology was made much freer.
* Privatization began to improve the efficiency of industrial units, SOEs started privatizing slowly.
* Import controls through licensing has been **virtually** abolished except for consumer goods.

  Import duties have been reduced in stages.
* Foreign Exchange rate of Rupee is today determined by demand and supply conditions in the market.

10.4.A) FOREIGN INVESTMENT POLICY:

Foreign Investment is viewed as a means of building inter-firm linkages in a world which transnational corporations are increasingly operating on the basis of network of Global connections. Net foreign investment inflows into India grown up to $20 billion in 1996-97. Recognizing the Foreign Investment importance the reform package designed to attract Foreign Investors.

* The Foreign Exchange Regulation Act (FERA) was amended.
* India signed the Multilateral Investment Guarantee Agency (MIGA) convention and became a member to promote foreign investment.
* Foreign Investment approvals up to 51% of equity in a specified list of 34 priority industries was made automatic.
* Investment above 51% equity was also permitted on the basis of case by case approvals given by Foreign Investment Promotion Board (FIPB).
* The procedure for Indian companies to invest abroad and develop Global linkages also streamlined and made easier.

10.4 B) CAPITAL SECTOR REFORMS:

As a part of reforms the capital market also been initiated
changes, SEBI has been in operation and given statutory power in February, 1992. The Office of Controller of Capital Issues was abolished in May, 1992.

* SEBI governs various aspects of the stock market and intermediaries operating with a view to improving trading practices.
* Private sector mutual funds has been allowed to operate subject to SEBI rules.
* A National Stock Exchange (NSE) is being set up to serve as a model exchange providing a nationwide screen based trading and electronic clearing and settlement systems.
* Foreign institutional investors such as pension funds mutual funds etc., have been allowed to invest in the capital markets subject to SEBI registration.

10.4 C) STATE OWNED ENTERPRISES (SOE) REFORMS:

Reforms in SOE sector aimed at increasing the efficiency of the SOE sector and reducing the deficit which, loss making units impact on the budget.

Budgetary support in the form of non-plan loans to loss making SOEs is being disinvested. SOEs also allowed to form Joint Ventures and also to raise fresh equity from the market to finance their expansion plans.

Structural reforms also involves social costs may arise for several reasons. Fiscal discipline forces limits on government spending and this may affect the pace of implementation of programmes in the social sector. Economic restructuring may
involve temporary loss of jobs in certain sick companies and unviable units as labour is redeployed into new units.

10.4 D) SOCIAL SAFETY REFORMS:

* A National Renewal Fund has been set up to fund schemes for compensation, retraining and redeployment of workers affected by the economic restructuring.
* The public distribution system has been strengthened and expanded in 1700 identified blocs.
* Expenditure on social sector including rural development, health, education substantially given preferences in resource allocation.

10.4 E) INDIAN PRIVATIZATION IN 1997:

Disinvestment commission chairman G.V. Ramakrishna stated that "unless there was no coordinated approach towards disinvestment there is likely to be a loss to the exchequer through lower realization of sale value". The specific recommendation made for six SOEs on 17th April, 1997. They are Bharat Aluminium Company Ltd., (BALCO), Madras Fertilizers Limited (MFL), Bongaigon Refineries and Petrochemicals Limited (BRPL), Manganese Ore India Limited (MOIL), I.T.I. Ltd., and H.T.L.

The process of Privatization differ from company to company. Outright sale of HTL shares, 74% off loading equity of Government in BALCO, ITI and BRPL. 50% off loading in MFL and 49% in MOIL. Immediate privatization of 40% BALCO. For HTL 50% shares being offered to a strategic partner through competitive bidding. In the case of BRPL 50% of shares sales to Indian or Foreign
Company. For ITI the initial sale of 50% shares of to a strategic partner with an agreement for further dilution of Govt., equity to 26% through public sales.

In MFL the commission suggested that Govt., to hold 50% and rest 50% for public offer. In the case MOIL Govt., should not sale more than 49% because of the performance of the company is good and its public monopoly there is no point to transfer this as private monopoly.

10.4 F) POLICY SUGGESTIONS :

India needs a pragmatic approach not an ideological approach to SOEs in order to succeed privatization.

Here we had outlined four issues of important bearing.

Firstly that the selection of strategic partners should be through a process of pre-qualification in order to identify and short list only suitable bidders who could bring in necessary technological or financial inputs for the SOE concerned.

Secondly, the issue of the voluntary retirement scheme (VRS) that in view of the considerable uncertainty among the various managements and employees there needs to be a clear cut policy statement of the terms VRS on a long term basis.

Thirdly, the need to provide adequate funds to the SOE managements for disinvestment process out of the disinvestment fund which has proposed to establish recently by the disinvestment commission (February, 1997).

Finally, the condition for privatization of SOE shares through the book building process could be established to meet the
requirement of investors could be facilitated if SOEs which were earlier divested and which are proposed for privatization are directed to join the Nation Securities Depository Ltd., (NSDL) and have their shares registered with it to meet the various concerns of the investors, including speedy transferability of shares.

10.4 G) COMMERCIALIZATION / RESTRUCTURING SOEs:

By dismantling earlier regulations from a large number of new directives and regulations, the aim is to overcome SOEs insufficiencies and strengthen cost-benefit thinking in SOEs management. The new directives and regulations has to focus on

a) industrial cost-reduction through greater cost discipline
b) control mechanisms on the use of investment funds to secure move.
c) steps to promote the improvement of enterprise management and finance, and
d) the use of indirect instruments for example profitability and the use of retained earnings to stimulate the intensification of production.

The main coefficients by which SOEs have to be evaluated based on net production, net profit. Profitability as the measurement criterion of rational resource use in production. In order to commercialize SOEs before going for privatization.

Private ownership can produce greater efficiency than the Government only in the presence of adequate competition in the economy. Competition provides the incentives for firms to allocate resources efficiently the only strategy is disinvestment.
of government equity, in this context the problems are under pricing the share prices and paying high commission for under writings, these will jeopardize the privatization results. Restructuring SOEs before privatization is vitally important. Underpricing shares causes wastage of money of tax payers, selling shares quickly, and spending too much on underwriting and advisory fees. In privatization programmes too much attention has been paid to change of ownership and not enough to competition improvement / efficiency in SOEs in all selected sample economies including India's SOEs.

CONCLUSION

This study examined the issues of Privatization schemes in the developing economies nearly a decade. The role of dependency school of thought in the process of development in observed developed economies is lacking relevance. And the role of Bretton Wood Institutions like International Monetary Fund (IMF) and World Bank is vital and these promotes and helps to initiate the Privatization process from externally.

The SOE sector's performance has been declining and the restructuring is imminent and that gives scope for privatization success that is the reason developing economies following the Public Sector's reforms.

The Govt.'s initiation began by the adjusting economic structures and adopting stabilization and liberalisation programmes.
Finally the privatization in all these sample economies started selling the State Owned Enterprises equity partially or fully depending on the firm to firm case.

Thus fulfilling all the objectives the Privatization in developing economies strongly believes in rectifying the Public Sector's list but in reality the fact is not the same.

Privatization can best be regarded as a medium term supply side economic policy, a logical complement to a broad private sector development rather than a Panacea for the all ills endured by those developing economies.

Privatization in India would bear fruit, if aspects of exit policy, simplified labour laws, health care and education at affordable costs and unemployment insurance are . . addressed carefully. This could be taken care of by further research.